

## Section 5 as a Bridge Toward Convergence

Albert A. Foer

American Antitrust Institute

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### 1. The FTC should use Sec. 5 as a bridge toward convergence with Europe.

Our interest today is in practical applications of Section 5 that go beyond the other antitrust laws. The context for the ideas I will raise is international. One of the primary missions of the antitrust enterprise in the coming years must be to move toward a system of enforcement that has coherence and practical workability on a global playing field. I intend to focus on some ways in which Section 5, with its particular potential for prospective clarification of the law, can be used to bridge gaps with the European Union and other civil law jurisdictions.

This context is important because there are now more than one hundred nations with their own antitrust laws and there is no overarching institution for formally harmonizing these laws or for resolving disputes involving cross-border transactions and/or behavior. With the relatively recent breakdown of Doha Round efforts towards convergence, it will be up to the leading antitrust jurisdictions, i.e. the US and the EU--one a common law jurisdiction, the other civil law, each with its own traditions and needs—to try to bring as much harmony as possible to the antitrust world. This can be achieved to an important extent through the tools of guidance that are familiar to both the FTC and the EU.

As we head into what appears to be a global economic recession, we can predict that pressures will build to limit trade, to promote protectionistic policies, and to reverse the positive momentum that has characterized international competition policy in so many ways since the late 1970's and early 1980's when the

principal international issue was the extent of our extraterritorial reach and I was head of an FTC task force looking into allegations that our antitrust laws had become an obstacle to a strong US presence in an increasingly global economy.<sup>1</sup> (We concluded, incidentally, that the charges were mostly wrong but that there were adjustments that the Commission should consider in light of increasing cross-border trade.) I believe that if the US and the EU can now work together to formulate and present more of their competition policies in a common language, they together will have a better chance of achieving what I take to be their common goal of strengthening the role of antitrust throughout the world.

At the current time, it seems to me that, philosophically, the FTC is considerably closer to Rue Joseph II in Brussels than to its neighbor on 10<sup>th</sup> and Pennsylvania. Although there are undeniable complexities if the FTC stakes out positions too different from the DOJ's, I believe that the two institutions are intended to be different and that Section 5 and the processes that permit its interpretation to evolve make it and the Commission a better candidate than the Sherman Act and the DOJ for attempting to bridge the gap between European and American competition policies. The DOJ's ideological constraints could be loosened in the future. In the meanwhile, I urge the FTC, while consulting with DOJ, to take the initiative in seeking modes of convergence with the EU.

2. Sec. 5 and Article 82 have similarities that can be emphasized through various mechanisms of guidance that will give common structure to their inherently vague meanings.

Let us begin by recognizing a few important similarities between Sec. 5 and Article 82 of the Treaty of Rome. One deals with "unfair" methods of competition, the other with "abuse" of a dominant position. Both "unfair" and "abuse" are open-ended words that are normative in nature, certainly not restricted to a narrow

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<sup>1</sup> See Albert A. Foer, "International Implications of Section 7 Enforcement," 50 Antitrust L.J. 819 (1981).

efficiency-based meaning. They are actually quite similar. What is not unfair is not abusive; what is not abusive is not unfair. Or so it could be defined. Both of these tests of commercially incorrect behavior are fundamentally vague as stated and require structure in order to avoid their arbitrary and unpredictable application. It is in the common interest of the EU and the US to find the areas in which they can express their interpretations of Section 5 and Article 82 with similar guiding language.

Both concepts deal with monopoly power in the sense that they are understood to apply to firms with very high market shares. But market power can be exercised unfairly or abusively with anticompetitive effects in certain situations without having monopoly levels of market share. Whereas the Sherman Act clearly applies to firms that have the status of economic monopoly, Article 82 clearly applies to lesser levels of market power in which a firm has achieved dominance.<sup>2</sup>

I believe that Sec. 5 can and should be applied with a realistic and practical assessment of a firm's ability and incentives to exercise market power and its effects; and that a firm which is dominant in actuality and which engages in an unfair method of competition should be reachable under Sec. 5 even if its market share is less than the "70 percent or so" that often characterizes Sherman Act decisions.<sup>3</sup> The concept held in common is, or could be, that when a firm has so much power over its market that it is capable of undermining a competitive market by unilateral actions, it can be held liable for abusing that power.<sup>4</sup>

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<sup>2</sup> Einer Elhauge and Damien Geradin, Global Antitrust Law and Economics, (2007), 268. Andrew I. Gavil, William E. Kovacic, and Jonathan B. Baker, Antitrust Law in Perspective (2002): "...EC policy and jurisprudence tend to define dominance as occurring at market share thresholds of 40 to 50 percent—considerably lower than the 70 percent or so that American courts usually associate with monopoly power in Section 2 cases." 676.

<sup>3</sup> The US Supreme Court has indicated that market shares above 66% indicate monopoly power without clearly specifying the lower boundary. See *US v. duPont*, 351 US 377 at 379 (1956). The EU expects to release a guidance document shortly on how it intends to interpret Article 82. The initial public draft indicated that market dominance could be found as low as 25%, effectively creating a safe harbor below that.

<sup>4</sup> Early case law in the EU "seems quite parallel to the U.S. formulation of a power to exclude competition or control prices, and raises similar issues." Elhauge and Geradin at 267. More modern cases have stated

The EU is currently on the verge of releasing a detailed guidance document on its interpretation of Article 82.<sup>5</sup> When this new “guidance” becomes public, it will provide a basis for detailed comparisons. Hopefully, the FTC will be able to work jointly with the EU or at least with the EU’s approach in mind, to provide comparable, if not identical guidance, through adjudicated cases, speeches, guidelines, formal rules, and other forms of guidance, which can be directed at specific categories of abuse.

In this way, the FTC can help bridge a gap that has probably been exaggerated in the past, when a small proportion of high profile cases were decided in different ways by the DOJ and the EU. In recent years, as the EU has moved in the direction of more and better use of economic science and a new emphasis on the importance of effects rather than structure, and as the FTC has developed its own jurisprudence that does not always go lock step with the DOJ,<sup>6</sup> the potential convergence between the FTC and the EU has become a reachable and desirable objective. I do not mean to imply by this that the FTC can ignore the DOJ or act as if it were a sovereign and I do not mean to suggest that the FTC should take its marching orders from Europe; rather, I am suggesting that as the FTC gives renewed consideration to the meaning of Section 5, it should keep in mind that there are potential benefits in taking European learning and experience into account and in seeking ways to bring the two antitrust jurisdictions closer together through processes of formalized guidance.

Let me now provide several examples.

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that the basic test of a dominant position is whether a firm has the “power to behave to an appreciable extent independently of [its] competitors or to gain an appreciable influence on the determination of prices without losing market share.” Id. This may be somewhat broader than what the Sherman Act cases hold.

<sup>5</sup> The US has no such document, although the Horizontal Merger Guidelines reflects a similar approach to spell out how a major section of the antitrust law is to be interpreted. Such guidelines are more typical of a civil law than a common law approach, and indicate a potential pathway for convergence.

<sup>6</sup> I applaud the Commission for not allowing the DOJ’s recent statement on Section 2 stand unchallenged as an expression of the Section 5’s approach to unilateral conduct. However, DOJ’s publication suggests the desirability of an FTC statement providing guidance on its interpretation of Section 5.

3. “Unilateral withholding” is an example of a Section 5 violation that does not necessarily violate the Sherman Act, but which can be viewed as an abuse of dominance.

We have seen circumstances in the electricity industry, most strikingly in California, where an electric generator has been able to produce significant increases in price by strategically reducing its output, for example by closing a plant for maintenance at a time of peak demand when the industry is operating close to full capacity.<sup>7</sup> A successful withholding strategy appears to require highly inelastic demand on the part of consumers and a temporary situation that can be exploited by a strategically situated, but not necessarily monopolistic, firm.

Strategic unilateral withholding by a non-monopolist would arguably violate Sec. 5, but perhaps not the Sherman Act, if the following elements are present:

- a. Highly inelastic demand at a time of peak capacity utilization; and

Such withholding undermines efficiency in the market; and <sup>8</sup>

- b.

It is unfair in the sense that it is opportunistic or coercive. For example, there may be a legitimate expectation by customers that electricity production will

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<sup>7</sup> See Diana L. Moss, “Electricity and Market Power: Current Issues for Restructuring Markets (A Survey)”, Environmental & Energy Law & Policy J. 11, 15-20 (2006), calling withholding “a relatively novel form of market power in an industry that has traditionally been concerned with exclusionary conduct.” At 18. It has been shown that market power can be exercised not only during peak periods but during off-peak and shoulder periods too. A recent merger complaint by the DOJ alleges that the potential of withholding capacity would be among the reasons the merger would have been illegal. U.S. Department of Justice, Complaint, U.S. v. Exelon Corp. and Public Service Enterprise Group, Inc., Case No.: 1:06CV01138 (June 22, 2006), paragraphs 34-35, available at <http://www.usdoj.gov/atr/cases/f216700/216785.htm>.

<sup>8</sup> A resulting price increase would be evidence of an anticompetitive effect.

not be slashed in an arbitrary way during peak demand when they have no alternatives or even the knowledge of what their supplier is doing.

The electricity example occurs in the context of a regulated sector. This fact would not deprive the FTC of regulatory authority, which is shared with FERC under the Federal Power Act.<sup>9</sup>

Would there be a remedy the FTC could employ against unilateral withholding?<sup>10</sup> Most likely the Commission would not act in the electricity context in the absence of a pattern of repeated behavior. A possible remedy could be to enjoin the behavior and require a demonstration of legitimacy prior to future withholdings of a defined nature. In the PacifiCorp merger,<sup>11</sup> the remedy was divestiture.

Could there be a Section 5 unilateral withholding example in an unregulated industry? Certainly. Consider the possibility of a manufacturer of flu vaccine closing one of its plants during flu season for the purpose of creating an artificial shortage.<sup>12</sup> Assume there are three manufacturers of this vaccine, each with multiple plants, and that no firm has more than 35 percent of the market. Assume further that no new entry is possible during the current flu season.

But wouldn't a firm necessarily have Section 2 monopoly power to enable it successfully to withhold output and raise prices? In the case of electricity, this may

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<sup>9</sup> That the Federal Power Act does not remove the electric industry from antitrust oversight was made clear in *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973), available at <http://supreme.justia.com/us/410/366/>.

<sup>10</sup> For example of an FTC case involving withholding, see the acquisition of The Energy Group (Peabody Coal) by PacifiCorp, analysis of proposed consent order at <http://www.ftc.gov/os/1998/02/9710091.ana.htm>. The analysis shows how withholding for a short period by a vertically integrated energy company can result in a price hike. The remedy here was divestiture.

<sup>11</sup> The Energy Group, note 10 *supra*.

<sup>12</sup> See Albert Foer, Robert Lande, and F.M. Scherer, "What Do Exit Polls and Flu Vaccine Shortages Have in Common?", *FTC:Watch* (February 14, 2005), available at <http://www.antitrustinstitute.org/Archives/379.ashx>.

be a matter of market definition. If the market is defined very narrowly and in terms of a time period that may be measured in minutes or hours, perhaps one can build a case for the temporary but repeated exercise of monopoly power. But it is not clear that the Sherman Act can or will be stretched in this manner, whereas Sec. 5 can focus on the effects and use it to imply the pre-event market power.<sup>13</sup>

In the case of the flu vaccine, if all available vaccine is being demanded at the height of flu season and all plants are operating at capacity, even a manufacturer with a relatively low share of the market could unilaterally close one of its plants, perhaps temporarily, be able to raise its own prices in the face of inelastic demand and reduced supply, and benefit (along with its rivals) from the higher price, provided the higher price on a lower output is expected, on balance, to increase profitability for the firm. The remedy here would be a mandatory injunction to resume production of the vaccine.<sup>4</sup><sub>1</sub>

Thus, unilateral withholding may be an example of a non-monopolist dominant firm, perhaps defined with respect to the price sensitivity of the residual demand it faces, abusing its position of power and engaging in an unfair method of competition, and that both the FTC and the EU could likely agree on a statement to this effect.

#### 4. Abuse of “Buyer Power” may violate Sec. 5 without monopsony-level market power.

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<sup>13</sup> In this, one might argue that the Section 5 violation is of a nature that the Sherman Act, properly construed, could reach it, but I tend to think it is enough of a stretch that the justification for FTC action should not have to rest on making a prediction of this sort.

<sup>14</sup> Compare this hypothetical with the FTC’s Analysis of Proposed Consent Order in the Stone Container case, <http://www.ftc.gov/os/1998/02/9510006.ana.htm>. In that case, the respondent, apparently not a monopolist and facing excess demand in the industry, unilaterally closed several of its plants while acquiring its competitors’ inventory, with the intent of encouraging competitors to raise prices. This was treated as an invitation to collude, in violation of Sec. 5. In my hypothetical, the problem is not excess capacity and there is no need for competitors to follow suit in order for prices to increase.

A second example of a dominant but not monopolistic firm engaging in an unfair method of competition could be found in the area of buyer power. For a variety of reasons, a power buyer can exercise disproportionate, anticompetitive bargaining power over its suppliers when it has a market share far below that required for a monopolistic seller.<sup>15</sup> The AAI points to the emergence of large buyers as a prominent feature in many sectors of the economy<sup>16</sup> and defines buyer power as “the ability of a buyer to depress the price it pays a supplier or to induce a supplier to provide more favorable nonprice terms.”<sup>17</sup> This encompasses both classic monopsony and what the AAI refers to as “countervailing power.” Both monopsony and countervailing power can have competitive effects that are beneficial or harmful, which means that outside of the buyer cartel context they need to be assessed under the rule of reason. Monopsony and countervailing power differ in the degree of dominance required to exercise market power:

Since classic monopsony power is the mirror image of monopoly power—a large degree of market power—classic monopsony power is normally associated with a large share of the relevant market, approximately 70% or more. In contrast, both theory and evidence suggest that a firm can exercise countervailing power in many market settings with a substantial but nondominant share, perhaps as little as 10-20%. Countervailing power, therefore, is likely to be exercised more frequently than classic monopsony power and its effects, whether beneficial or harmful, are likely to be more widespread.<sup>81</sup>

For example, a retailer that controls 20% of a national market can make both price and nonprice demands on an individual supplier via a take-it-or-leave-it or all-or-nothing offer that in practice gives the supplier less real choice than a consumer would have if one seller controls 90% of the same product market. In some cases,

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<sup>15</sup> On buyer power, see chapter three, “The New Kid on the Block: Buyer Power,” in American Antitrust Institute, *The Next Antitrust Agenda* (2008), available at [www.antitrustinstitute.org](http://www.antitrustinstitute.org).

<sup>16</sup> *Id.* At 95 (citing the packing of meat, the processing of chicken, the harvesting of hardwood timber in the Pacific Northwest, the employment of professional athletes, the provision of health insurance, and the retailing of toys and games, groceries, and books).

<sup>17</sup> *Id.*, at 99.

<sup>18</sup> *Id.*, 104.



this should be deemed a sufficient degree of dominance to warrant intervention by both the FTC and the EU, in the event that the dominance is abused.

There are undoubtedly difficult questions relating to what would constitute an unfair method of competition or an abuse of dominance by a non-monopsonist power buyer,<sup>19</sup> but if the possibility of anticompetitive effects is realistic and will play an increasingly important role in economic life, as we strongly believe, then the FTC and EU should both be trying to provide guidance as to the line between proper and improper exercise of buyer power. If the guidance is joint or at least quite similar, this would be a major contribution to convergence and would help clarify an important area of competition policy that is probably still in its infancy.

#### 5. Price discrimination policy could be developed under Section 5.

It is well-recognized that price discrimination by a company with market power can be anticompetitive under certain circumstances, but that it can be pro-competitive under other circumstances.<sup>20</sup> The Robinson-Patman Act, which is our principal law for dealing with price discrimination, is generally not enforced by the federal government because of its complexity, the nearly open-ended exemption for meeting the competition, and its propensity for being used for anticompetitive outcomes. Section 2 of the Sherman Act can also be used against price discrimination in certain circumstances. It is fair to say that price discrimination is a confusing area of law, in which the competitive process can under some circumstances be harmed and businesses can find it difficult to ascertain whether their price (and sometimes non-price) policies expose them to liability.

But Section 5 could be utilized, again in consultation with the Europeans, to develop a series of parallel guiding statements as to what practices will be deemed

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<sup>19</sup> Id., 103-130.

<sup>20</sup> See pages 130-135 of the AAI's Next Antitrust Agenda, op. cit. note 16 supra.

by the FTC and the EU to constitute unfair methods of competition. We believe that a market power screen is necessary in this regard, but that price discrimination can, under identifiable circumstances, be used anti-competitively by a firm with less market power than a monopolist.<sup>12</sup>

6. Developing structure for RPM rule of reason cases could be an example of bridging the gap between Section 5 and Europe's Article 81.

Article 81 is generally similar to Section 1 of the Sherman Act. Section 5 can be utilized to create a convergence with the EU in certain areas. Here we focus on the example of Resale Price Maintenance ("RPM").

The Supreme Court, in *Leegin*,<sup>22</sup> called on the legal system to develop a methodology for dealing with resale price maintenance under a Rule of Reason regime. One potential approach already exists in the form of the EU block exemption regulation applicable to vertical restraints and the guidelines associated with it.<sup>32</sup> According to the EU's guidelines, there is a rebuttable presumption that an agreement which contains RPM is anticompetitive and will not have positive effects or that, where efficiencies are likely to result, these will not be passed on to consumers and/or that RPM is not indispensable for creating these efficiencies. But it is always possible for the firm in question to come forward with substantiated

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<sup>21</sup> *Id.* At 133: "All that would be required [under an AAI proposal for reforming the Robinson-Patman Act] is proof that competition was sufficiently imperfect that a seller had the incentive and the ability to undertake significant, persistent, unjustified favoritism."

In Europe, Article 82(2)(c) offers parallel protection to the R-P Act, prohibiting dominant firms from "applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage." Elhauge & Geradin, *op. cit.*, 399. Article 82(2)(a) also prohibits a dominant firm from "directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions." *Id.* At 400. We are not endorsing an interpretation of Section 5 that would prohibit exploitation of legitimate market power through excessive pricing.

<sup>22</sup> *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705 (2007).

<sup>23</sup> This discussion is based on Luc Peepkorn, "Resale Price Maintenance and Its Alleged Efficiencies," 4 *European Competition Journal* 201 (June 2008), which goes into more detail both on European policy and on the potential applicability in the US. The AAI's position on RPM, calling for the FTC to develop a structured rule of reason approach, is set out in AAI, *The Next Antitrust Agenda*, at 88-92.

claims that the RPM will bring about efficiencies. When this occurs, the EU then is forced to show the likely or actual negative effects. If the efficiencies outweigh the negative effects and the other conditions such as the indispensability test are also fulfilled, the agreement is not prohibited.

The EU will be re-evaluating its Vertical Restraints policies in 2010, and the work on this has already begun. The EU case law and practice towards RPM is apparently more flexible than the US *per se* approach that was overturned. It is also more forthright and explicit, in that it contains no Colgate doctrine to confuse and perhaps obliterate any RPM prohibition. I believe that the FTC could apply its jurisdiction under Section 5 and work in conjunction with the EU to agree on a rebuttable presumption and burden shifting approach very similar to, if not identical with, the current EU guidelines to arrive at a structured rule of reason approach which meets the Supreme Court requirements.

With respect to the RPM question and the price discrimination question addressed in the previous section of this paper, I am making the independent recommendation that the FTC use its tools for providing prospective guidance to bring greater clarity and predictability, with or without EU coordination. Taking the long range picture into account, I think it would be worth the additional effort to try to produce compatible if not fully harmonious guidance.